

# Fraud Intelligence

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FEATURE › FRAUD (RISK) MANAGEMENT

## The answer lies within

To tackle fraud properly, fraudulent conduct must first be recognised and regarded as deviant behaviour: once that consensus is reached, people in the organisation will be capable of formulating their own response, says **Veronica Morino**.

Organisations will continue to be hit by fraud and corruption and will always seek to protect themselves. There is growing unease, however, that despite ever more rules, policies, internal controls, risk assessments, monitoring activities, training programmes,... the incidence of fraud is not reducing, nor do companies appear better prepared to respond. In other words: true organisational “resistance” [1] remains elusive.

In a previous article [2], we described limitations to the existing approach taken by many “fraud experts”, including the pitfalls of the “fraud examination” model. There appears to be a reluctance to accept fraud as a commonplace aspect of human behaviour of individuals and groups (albeit one that can be managed); instead, organisations are encouraged to believe they can contain the problem through imposition of controls. We prefer to take a more holistic perspective, aiming to empower those working in the organisation to find fraud and corruption early and exercise their own “control” rather than rely on “the experts”.

The contention is that fraud in organisations may be explained, at least in part, by failure to reach a common understanding of normal and unacceptable conduct; this has to be the start-point.

### The Fraud Paradox – fraud is common but we are very poor at spotting it

The definition of an act as “fraudulent” is itself a challenge. Individuals recognise certain acts are morally wrong and that most other people in the same society will share their view and react in the same way. However, rules and norms differ between groups: an individual might conceivably transgress in one by obeying in another. The difficulty of defining fraud may lie in such tension, even paradox:

1. Fraud touches on core values; it is, at once, common and deprecated in every historical period [3], geography and culture;



2. Individuals rarely seem able to identify fraud, whether they are bystanders, victims or perpetrators, and if at all, often only long after it commences.

These points may help explain why, even if a society is able to agree on a common definition of fraud, individuals and groups within it might still not be able to recognise it when it occurs, as they would if they were outsiders.

### Fraud as a departure from social norms

Applying generic reasoning on deviance [4], before fraud can be addressed, it must be recognised as wrong. In other words, something is “fraudulent” when people say it is. Deviance means the individual, or group, perceives an act, situation or event to depart from social norms [5] (“**1. Recognition**”), which implies familiarity with those norms and knowledge of the act, situation or event (not easy in the case of fraud). Once the deviance is recognised it has to be categorised as such and reported (“**2. Categorisation and Reporting**”). The individual (or the group) must achieve acceptance by others that the situation is fraudulent (“**3. Acceptance**”), and that it meets with an appropriate response (“**4. Action**”). Unless ALL these conditions are satisfied, fraud will not be treated as a deviant act.

That fraud is so common but still not widely recognised might be due to failure by organisations to frame it as deviant. Individuals, groups, an organisation or even the whole society could fail to establish adequate notions of fraud, a point illustrated in the following example: *The managing director of a company wanted two new iPhones for his children. They were sold out in his hometown but he heard there were a couple left on sale in a town 450km away. He rang his assistant and told her to obtain the two phones. She learned that one of the managers was going to a meeting in that town the following day and asked him to buy the phones. Only during the subsequent investigation, when confronted with the story, did the assistant and manager realise that it entailed theft of company time as well as fraud – it transpired that the managing director had paid for only one of the phones while the other was registered to the company.*

### Obstacles to seeing fraud for what it is

Developing further the generic reasoning on deviance and the four stages that need to be in place for it to be recognised, we explore below some of the common processes that allow or even foster the non-recognition of fraud as deviance. As a result of those mechanisms, fraud may not be seen, condemned, talked about or counteracted as it should.

#### 1. Recognition – knowledge of the norms

One obstacle to the recognition of fraud may be inadequate awareness of norms and values but it is hard to see lack of cultural awareness as an explanation of fraud. Sutherland [6] says that individuals are able to gradually detach from a definition of honesty if they realise that their professional success depends on the capacity to perform unethical or illegal acts. The techniques used to justify illicit behaviour are termed “rationalisations”. Rationalisations may be accepted only within a specific sub-group of society and fraud may be committed even if there is knowledge about cultural norms and values on a more general level.

#### 2. Categorisation and Reporting – contingent on clear understanding

Categorising facts as fraud and being able to report them to others can also meet with many barriers. Not knowing the facts, due to the hidden nature of fraud, is more likely than a lack of familiarity with norms and values. When reality is confusing, individuals delay their response, look for guidance and refer to the behaviour of others. In addition, individuals tend to want to be part of a group and they will often “follow the flow”; this can lead to “diffusion of responsibility”, in which the ability to distinguish between normal and deviant behaviour is lost, as happened in the following case: *During an investigation a “Recommendation for*

*selection” sheet for a fraudulent supplier came to light. The form bore the signatures of approval of all board members. It was then discovered that the supplier’s beneficial owner was the former site manager. He had signed the recommendation form at the end of his last project for the company. As his was the first signature, everyone else had simply added theirs, nobody had questioned the selection.*

People are inclined to believe that others behave normally and with common sense. They will tend to discount suspicion and seek a socially acceptable explanation for activity that is out of the ordinary.

#### 3. Acceptance – necessary consensus

The theatre analogy is helpful here: in drama, as in everyday interactions, individuals formally act on a stage, delivering as expected by the group and adhering to conventions with meaning for the audience. There is also back-stage, where they may behave differently. Bystanders (the audience) do not see back-stage so lack crucial insight that would inform their understanding of the public performance. Similarly, fraud may play out unseen and misunderstood even when all the facts are present: a fraudster is an actor but unlike in a drama, his motivations are not usually conveniently revealed in soliloquies or asides to the audience.

#### 4. Action – a matter of will?

Final recognition or resolution can only be reached with group consensus that a type of conduct is fraud, it is condemned and there is a will to confront it, as in this real case: *A local managing director had been abusing his position for years, leading to a culture where “everything was allowed”. At least half the senior managers were running their own small rackets, involving conflicts of interest, nepotism, collusion with suppliers and false reporting. The head of security recognised the problem and gathered sufficient evidence to dismiss the MD. Several other corrupt managers left voluntarily soon after and the honest people who remained were able to clean up the business.*

But even when fraud is recognised it may not be reported or acted upon: the absence of a protected communication channel, peer pressure, fear of isolation and/or reprisals may all favour silence.

In summary:

1. Fraud should be framed as a social phenomenon; it is riddled with inherent tensions (‘paradoxes’);
2. Fraud can only be analysed, condemned and dealt with effectively once there is common recognition that the conduct at issue is deviant.

Common definition and approach to fraud in an organisation proceeds through phases (“Recognition”, “Categorisation and Reporting”, “Acceptance” and “Action”); this understanding allows us to gauge how

well the threat is managed and where organisations stand today.

### Notes

1. The ability of an organisation inherently to become resistant to fraud and corruption (rather like a healthy and vaccinated person is resistant to common tropical diseases whereas a weaker, un-vaccinated person is much more susceptible). This requires fraud and corruption (i.e. the “disease”) to be recognised as both common but also deviant social phenomena, and the adoption of a more holistic and humane approach.
2. “Blinkers off”: counter-fraud, is it a self-serving profession? published in the April/May 2016 issue of Fraud Intelligence - <http://www.counter-fraud.com/skills-and-tools/surveys-and-research/blinkers-off-counter-fraud-is-it-a-self-serving-profession-114739.htm>
3. Fraud is instanced in the Code of Hammurabi, the earliest known legal code, dating from around 2250 B.C.
4. Rubington E. ,Weinberg, M. (eds.). 2005. Deviance – The Interactionist Perspective. 9<sup>th</sup> edition. Boston: Pearson Education, Inc.
5. Social norms are the rules of behaviour considered acceptable in a group or society.
6. Sutherland, E. H. 1983. White collar crime. The uncut version. (1<sup>st</sup> ed.:1949). New Haven and London: Yale University Press.

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